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C O N F I D E N T I A L SECTION 01 OF 04 PRAGUE 000563

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SUBJECT: CORRECTED COPY: EARLY ELECTIONS SCRAPPED, INTERIM GOVERNMENT FOR FORESEEABLE FUTURE

REF: A. PRAGUE 523

B. PRAGUE 527

C. PRAGUE 532

Classified By: Charge d'Affaires Mary Thompson-Jones for reasons 1.4 (b) and (d).

¶1. (C) Summary. Early parliamentary elections have been halted and it appears the interim government of Prime Minister Jan Fischer will continue to govern until the regular parliamentary elections in May 2010, although early elections are still possible. Fischer is focused on the economic crisis and passage of 2010 state budget as his top governing priorities and is seeking a renewed and expanded mandate from the Parliament in order to govern effectively. The recent to-and-fro on elections shows that the sixteen-year old Czech Republic is still working through the issues of a young democracy. However, there is no indication of economic instability: markets and businesses seem unfazed by the political maneuvering. Continuation of PM Fischer's government probably bodes well for U.S. interests, since the political parties are focused on domestic political and economic issues and appear willing to leave foreign policy to the career diplomats and defense policy to the military. End Summary.

Early Elections Derailed, Twice

¶2. (C) Mirek Topolanek lost a vote of confidence on March 24, 2009 and resigned on May 8. Jan Fischer was appointed to run an interim government until early elections could be held. This was supposed to be on October 9-10. The legislative procedure for having early elections was the same procedure that was used in 1998. Since there was precedent, everyone believed the same procedure could be used again. It probably would have worked if no one had raised a constitutional challenge. This time, though, a Member of Parliament (Milos Melcak) filed a challenge with the Constitutional Court and the procedure that was used to call early elections in 1998 was declared unconstitutional by the Constitutional Court. In a private conversation with an Embassy official, Milos Melcak said he filed the constitutional challenge at the behest of his lawyer, Jan Kalvoda. Kalvoda sat on the committee that drafted the original Czech constitution and was displeased with the way the parties circumvented the constitution in 1998 and wanted this year's attempt to have constitutional scrutiny.

¶3. (U) In order to get around this constitutional challenge, the Chamber of Deputies and Senate passed a one-time constitutional amendment that would allow an alternative way to call early elections - by dissolving the Chamber and permitting the President to schedule early elections. However, after passing the amendment two days earlier in Parliament, Social Democrat (CSSD) leader Jiri Paroubek declared that he would not support dissolving the Chamber on the morning that the motion to dissolve was to be put on the Parliament's legislative agenda - September 15.

Melcak and fellow MP Juraj Raninec hinted that a second constitutional challenge might be filed if the resolution to dissolve the Chamber passed. Paroubek said that this potential second constitutional challenge to dissolving the Chamber would leave the nation with no functioning Chamber and give the Senate sole legislative authority, albeit more limited than the full Parliament. He said that this would be unconscionable during the current economic and financial crisis.

¶4. (C) However, political analysts speculate that the real motive was either 1) to avoid having his own MPs vote against the motion to dissolve and reveal his tenuous leadership, 2) he believed he might not actually win the early elections if they had been held in November, or 3) if CSSD did win the elections they did not want to have to deal with the financial crisis and be tagged responsible for imposing tough austerity measures. Former CSSD Prime Minister Milos Zeman said Paroubek did it so his party would not lose state subsidies after the Parliament was dissolved. A political reporter for a respected daily told an Embassy official that several CSSD members told him that Paroubek had a late night/early morning meeting with lobbyist and lawyer Miloslav Jansta the day that he reversed course and, although, no one is saying what was discussed, Jansta is known to represent some of the biggest business interests in the Czech Republic.

¶5. (U) Regardless of the reason, Paroubek changed his mind and the motion to dissolve never reached the Parliament's September 15 legislative agenda. Elections will most likely now occur in May 2010. The Constitution requires that the regularly scheduled elections take place the month before the

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end of the election term, which is June 3, 2010. Thus, the elections must occur in May, as Friday and Saturday are election days and the first available days preceding the June 3 deadline are at the end of May. President Klaus met with Paroubek to discuss his decision to scuttle dissolving the Parliament. Klaus said he did not give up the possibility of early elections in January or February and will seek ways to secure elections sometime in that time frame, but only if the early elections can be held without the possibility of a constitutional challenge.

The Interim Government Remains -- For Now

¶6. (C) The Parliamentary session was closed on September 15 with no vote on the motion to dissolve, the parties have halted their campaigns and the focus has now turned to the interim government and the 2010 state budget. PM Fischer immediately called for a renewed, expanded mandate if he is going to govern for the next eight months (which would probably require a vote of confidence) and put the state budget forward as his top agenda item. Paroubek has announced his support for Fischer's interim government and said that the interim government "won it (a vote of confidence) some four months ago." ODS leader Mirek Topolanek, who fulfilled his promise to resign from Parliament if the vote to dissolve the Parliament did not pass, said that Fischer's ability to secure passage of the 2010 state budget could be viewed in itself as a vote of confidence for the interim government. However, failure to gain parliamentary approval for the budget by the end of the calendar year (the Czech budget year coincides with the calendar year) will raise serious questions about PM Fischer's ability to govern and could trigger a no-confidence vote.

Interim Government Focuses on Getting Economic House in Order

¶7. (SBU) PM Fischer and his interim government are clearly

focused on the 2010 state budget. His Finance Minister, Edward Janota, has worked up two budget proposals: One with a projected 230 billion CZK deficit (USD 13.5 billion) which is about 7 percent of GDP, and one with a 170 billion CZK deficit (USD 10 billion) which is slightly more than 5 percent of GDP. Fischer has made it abundantly clear that he wants the 170 billion CZK proposal, which includes tough austerity measures such as increased taxes, freezing state salaries, and cutting social benefits. The various political parties seem to be in agreement that the projected 230 billion CZK deficit must be tackled and is clearly the most pressing priority.

¶ 18. (C) The battle will come in deciding how the deficit is tackled. Topolanek and the Civic Democrats (ODS) will push for a cut in the mandatory services budget and higher VAT taxes, while Paroubek and CSSD will push for an elimination of the flat tax, introduction of progressive taxation and a cut in state projects such as environmental cleanup. The Chamber is set to debate the budget and austerity package on September 24 and can pass legislation necessary for the austerity package with a single vote instead of the usual three readings, due to an emergency procedure invoked by the Chamber. These austerity measures will require legislative changes and PM Fischer needs the support of a majority in both houses of Parliament to pass the necessary legislation. Instead of drawing a 170 billion CZK line in the sand, Fischer may need to compromise to ensure a budget is passed before January 1.

Political Uncertainty Not Affecting the Economy

¶ 19. (C) The political uncertainty has not appeared to have had any negative effects on the economy. Ceska Sporitelna Bank researchers noted that experience has shown that the Czech economy and financial markets do not react to domestic political turbulence. According to ING Bank London analyst Agata Urbanska, the Czech Republic stands out within emerging Europe to the "extent which foreign investors are prepared to ignore political developments." Only if the political instability were to lead to continuous problems with budget deficits and a build-up of public debt, did she believe this would change. Even though the 2010 budget deficit was likely to be very large, she argued that foreign investors were taking this rather well, given the economic recession and the Czech Republic's relatively low level of public debt (around 30 percent of GDP).

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¶ 10. (C) Patria Finance's David Marek pointed out to us that the political maneuvering has not led to a weakening of the crown or the stock market. In fact, since September 15, when CSSD announced it would not support early elections, the crown has actually appreciated to its highest level against the dollar since November 2008. The Prague Stock Exchange Index has increased from 1134 to 1161. Marek did not believe that international investors cared whether the 2010 draft budget would have a deficit of 5 percent of GDP or 7 percent. Much more important will be whether the next government will be willing to tackle the longer term structural reforms (e.g. pensions, health care), needed to ensure long-term fiscal stability.

Likewise, Election Day Has Little Impact on Czech Foreign Policy

¶ 11. (SBU) As noted above, PM Fischer has focused on domestic budgetary issues. His Foreign Minister, Jan Kohout and his Minister of Defense, Martin Bartak are both seasoned professionals who have adhered to the same path as the previous Czech government. Indeed, Minister Bartak, has made

clear publicly that even during these strained financial times when all of the Czech Ministries have been asked to make 10 percent cuts in their budgets, the MoD has every intention of continuing its ongoing commitments to international efforts in Afghanistan. Bartak reaffirmed this commitment to General Petraeus on September 15. (Note: The 2010 Czech foreign deployment bill passed smoothly through parliament in June 2010. End Note.) With respect to foreign policy, the Czech Republic establishes broad priorities for five-year periods. FM Kohout has not changed this approach. The Czechs' commitment to advancing bilateral relations with the U.S. remains strong, as does their engagement within the EU and NATO.

Things to Watch in Czech Foreign Policy

¶12. (SBU) While the Czech parliamentary election delay has not noticeably affected foreign policy, there have been other events which have, or may have, a substantial effect on Czech foreign policy. One obvious change is now that the Czech EU Presidency has come to a close, the Czechs have assumed a slightly lower profile within EU internal discussion. This is a natural result of handing over leadership of the EU, but the Czechs are always interlocutors eager to listen to USG thinking. While the Czech interest in our opinions continues, Czech ability to influence EU decision-making is not the same as when they led the EU. The conclusion of the U.S. missile defense policy review will affect on our bilateral relationship, at least in the short term. As a final note, the Czechs had slated several embassies for closure in 2007, but delayed acting upon this because of their responsibilities to speak on behalf of the EU Presidency in third countries. We have every reason to expect that the Czechs may now act on this and close several small embassies (mostly in Africa)

Comment: Young but Stable

¶13. (C) Fischer and his cabinet have done an admirable and statesman-like job of running the country, finishing the EU Presidency and tackling tough issues like extremism. So far, the Fischer government appears to be taking a similar approach to the budget problem. And although most Czechs are fed up with politicians -- a recent poll showed that only 1.8 percent of Czech citizens believe politicians -- the Fischer government is relatively popular, with almost two-thirds of Czechs wanting the Fischer government to rule until elections. Despite the recent political gyrations, day-to-day government operations continue normally.

¶14. (C) Sixteen years after coming into existence, the Czech Republic is still a young country coming of age and working through the details of governing. Political scientists readily agree that the Constitution has its flaws and recent events may reflect constitutional weaknesses. However, the Constitutional Court ruling that legislators may not dissolve parliament in way outside the Constitution is a victory for rule of law. That parliament and the President grumbled but heeded it is another. Sorting out imbalances between the legislative, executive and judicial branches is part of the growing pains of any democracy. The rule of law still prevails and we have no demonstrations in the streets -- just old-fashioned messy politics.